The Beacon Hill Institute:

Virginia STAMP Model and the Jefferson Institute State Tax Reform Proposal

Outline

- BHI Approach to Modeling

- Modeling the Sales and BPOL Taxes
  - Consumption, investment, value added and intermediate goods

- Modeling the Income Tax & M&T tax
  - Factor demand and the cost of labor and capital

BHI's Approach to Tax Policy

- Direct taxes are penalties on working and saving
- Subsidies are rewards for leisure and dissaving
- Supply equals demand (no Keynesian elements)
- Analysis needs to be "dynamic":
  a cut in a tax rate expands private
  economic activity

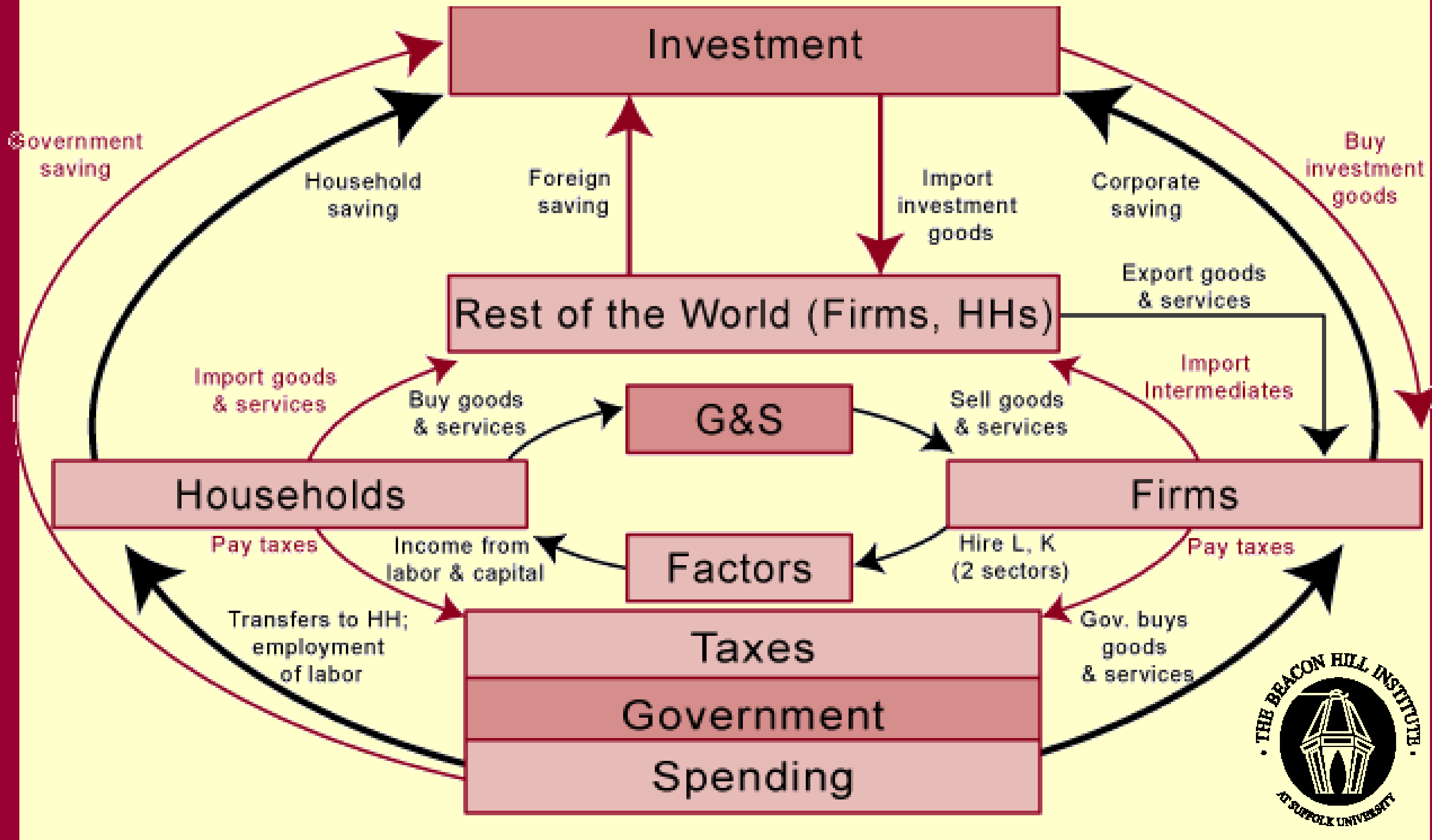
Tax Policy Analysis:

BHI's method is to build models that:

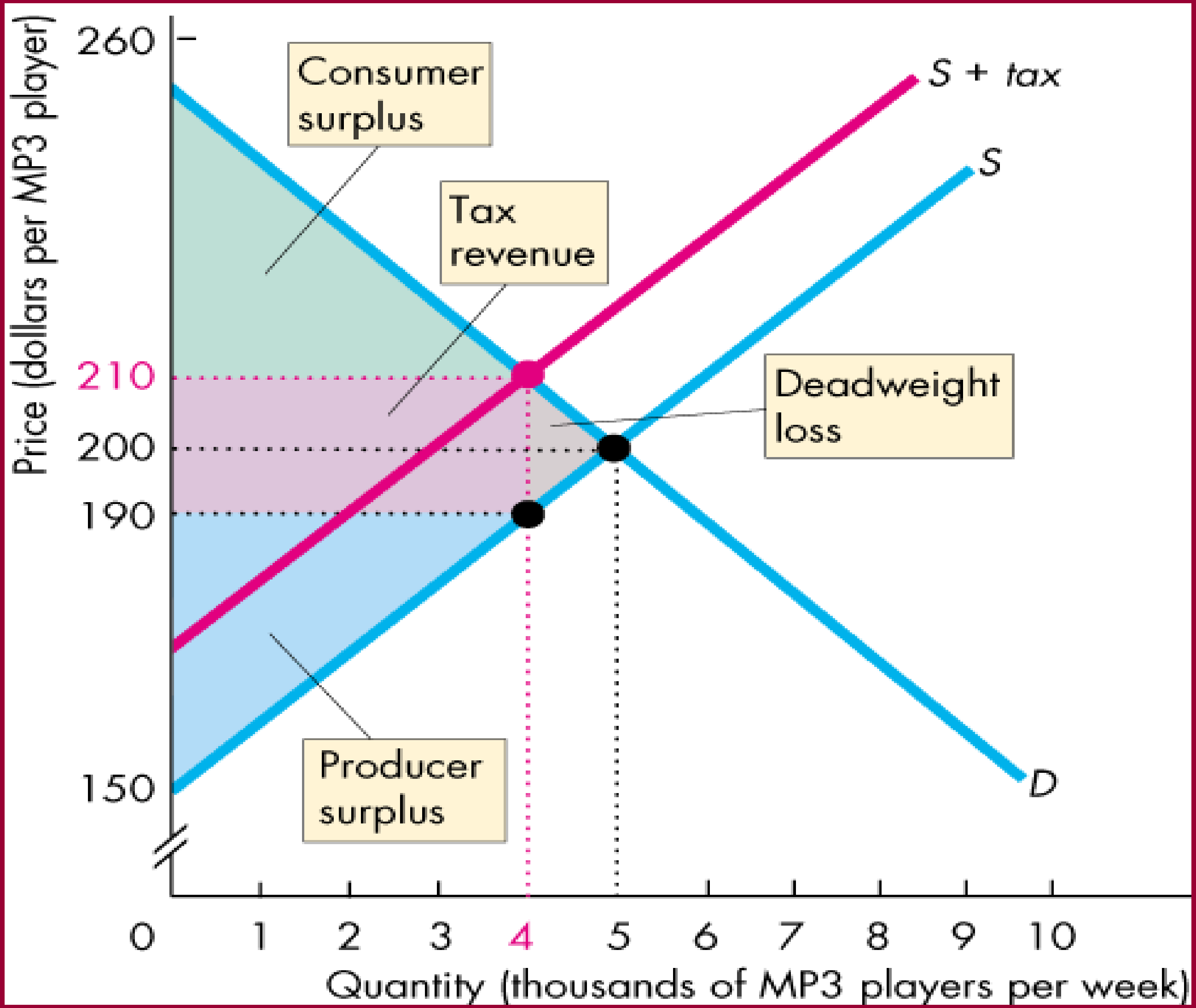
- Incorporate all markets and all important taxes
- Are solved as a system of equations, parameterized with realistic elasticities
- Are transparent: report all equations and elasticities

BHI CGE Models

Capturing the complexity of the Economy



Economics of Taxation



Sales and BPOL Taxes

- Increase the price of:
  - goods to the final user, and reduces the quantity of consumption;
  - some inputs to suppliers if they are the final user, eg office supplies, distribution of G & S, and construction supplies;
  - some purchases of investment equipment;
  - Increases government income
  -

Expansion of VA Sales Tax Base

- Expand sales tax to all services except healthcare
- Loss of private sector 29,000 jobs
- Investment drops by $208 million
- Real Disposable Income drops by $2.1 billion
- Real GDP falls by $3.8 billion
- Dynamic Revenue Gain of $1.9 billion

Eliminate the BPOL Tax

- Gain of 11,800 private sector jobs
- Investment increases by $94 million
- Real Disposable Income increases by $900 million
- Real GDP increases by $1.4 billion
- Dynamic Revenue gain of $581 million

Capital Taxes: M&T, Merchants Capital Tax

- Increase the after tax rental rate (cost) of capital relative to labor:
  - firms substitute labor for capital
  - Level of Investment is lower
- Increases government income

Eliminate M&T and MC Taxes

- Gain of 1,000 private sector jobs
- Investment increases by $425 million
- Real Disposable Income increases by $100 million
- Real GDP increases by $4.5 million
- Dynamic Revenue loss of $183 million

Personal Income Tax

- These taxes are imposed on the rental rate (payments to) to labor in the form of wages and salaries and the return on investment or capital.
- They raise the after tax rental rate (cost) of labor and capital, reducing the quantity demanded and supplied for each.

Personal Income Tax Changes

- Eliminate bottom two brackets, cut others by 9.25%
- Gain of 96,000 private sector jobs
- Investment increases by $17 million
- Real Disposable Income increases by $4.3 billion
- Real GDP increases by $11.2 billion
- Dynamic Revenue loss of $1.1 billion

Capital and Personal Income Taxes Reduce Factor Income

- Factor income is dependent on rental rate of labor and capital and factor demand across private industry and governments.
- Household gross factor income: Factor incomes, less factor payments to rest of the world and less employee portion of FICA.

Household Disposable Income

- Household disposable income: Gross income, less personal income tax and residential property tax, plus transfer payments.
- Taxes reduce households disposable Income, leading to a second order decrease in private consumption.
- Reduces domestic demand for Goods and Services, reducing factor demand for labor and capital, lowering factor incomes

Total Tax Changes

- 96,000+1,000+11,800-29,000 = 79,800 jobs
- $17 m+$425 m+$94 m - $208 m = $328 million investment
- $4.3 b+$100 m+$900 m - $2.1 b = $3.2 billion real disposable income
- $11.2 b+4.5 m$1.4 b-$3.8 b = $8.9 billion real RGD
- $-1.1 b-$183 m- $581m+ $1.9 b = $36 million dynamic revenue gain

Contact information:

The Beacon Hill Institute
Suffolk University
8 Ashburton Place
Boston, MA 02108

Phone: 617-573-8750
Fax: 617-994-4272

E-Mail:
bhi@beaconhill.org
Web: www.beaconhill.org